
M E M O R A N D U M

To: CalPERS Investment Committee

From: PCA Real Estate Advisors, Inc.

Re: Wilshire Q308 Investment Performance Report

Date: December 3, 2008

We have reviewed the Executive Summary of the Wilshire Associates Investment Performance report for the quarter ending September 30, 2008, which includes the composite results for CalPERS' Total Real Estate portfolio.

As at the end of the previous quarter, the Total Real Estate portfolio continues to be a tale of two stories: the Core segment and the Specialized (Noncore) segment. The Total Real Estate portfolio has performed in-line with its benchmark, the NCREIF Property Index, over the trailing 5- and 10-year periods. However, the severity of recent declines in the Special (Noncore) Real Estate segment have dragged the trailing 1- and 3-year Total Real Estate portfolio returns below the NCREIF Property Index, despite consistently strong returns from the Core Real Estate segment. These performance figures are detailed in the Table 1, below.

Table 1: CalPERS Total Real Estate Performance Breakdown

	<i>1-quarter</i>	<i>1-year</i>	<i>3-year</i>	<i>5-year</i>	<i>10-year</i>
Total Core Real Estate Private	-1.4%	9.7%	17.4%	21.7%	16.2%
Total Special Real Estate	-24.0%	-33.2%	-1.8%	8.0%	7.6%
Total Real Estate Portfolio	-13.7%	-14.4%	7.4%	14.8%	12.5%
NCREIF Property Index	-0.2%	5.3%	13.2%	14.2%	11.8%

The CalPERS Total Real Estate portfolio produced a -14.4% return for the trailing 1-year period. The NCREIF Property Index posted a return of 5.3% for the same period. The driving force behind this divergence was the performance of the Special (Noncore) Real Estate segment; in particular, CalPERS' large exposure to the housing sector.

Furthermore, while the Core Real Estate segment has historically been a strong relative performer, vis a vis the benchmark, we expect the ramifications of the current recession - which the National Bureau of Economic Research has confirmed started in December 2007 - to impact the cash flows on which these properties rely and, consequently, the resulting absolute performance the segment is able to produce. Core returns will therefore continue to erode. Moreover, the impact of leverage within this segment of the portfolio may cause it to underperform the benchmark. We note that the NCREIF Property Index badly trails the overall performance of actual market conditions. This fact is attributable to the use of appraisals to value assets, which consistently lag current market conditions. Thus, returns may overstate actual market conditions in the private markets.

We look forward to discussing this further with the Investment Committee and answering any questions.